

This letter discusses nexus. See *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992). (This is a GIL).

May 9, 2001

Dear Xxxxx:

This letter is in response to your letter dated March 14, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's Web site at www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter, you have stated and made inquiry as follows:

I am the editor of an annual book entitled, PUBLICATION.

My readership is primarily large software companies and accountants. My readership does not care what the tax rate is. They merely want to know what the rules are so they can follow them.

Over the years, a number of questions regarding nexus and software have arisen. In order to better aid my readership (and help insure that they properly collect your taxes), I have some questions I would like answered. In answering these questions, please assume that the software developer does not have any traditional nexus with your state: e.g., it does not have an in-state office, sales staff, and the like.

1. Does attending a trade show create nexus?
2. Does having a booth at a trade show create nexus?
 - a. Is there a minimum of days necessary to create nexus; e.g., does exhibiting for one day only create nexus
3. Does sending a salesman into the state for a sales call creates nexus.
 - a. Is there a minimum of days necessary to create nexus; e.g., does having a salesman in your state for one day only create nexus?
4. Does sending someone in to train, install, or debug software creates nexus?
 - a. Is there a minimum of days necessary to create nexus; e.g., does training, installing, or debugging for one day only create nexus
5. Is nexus determined annually? For example, if a vendor establishes nexus in July, 2001, by having a salesman in your jurisdiction for more than the minimum period, how long does the nexus exist. In other words, if the vendor never sends in another employee when does the nexus expire?

6. Is nexus retroactive? If the vendor establishes nexus in July 2001, and starts collecting sales tax, what requirement exists to collect sales tax on earlier orders?
 - a. Does it matter if the order has been processed but not shipped?
7. Once nexus, has been established how is it de-established? For example, if an office is set up in your state and then closed without further employment etc. is that sufficient to remove nexus?
8. Does simply having accounts with ongoing technical support/maintenance in your state establish nexus?
9. Do you distinguish between the sale of software and the license of software? Most software is never sold. Rather it is licensed by the developer to the user for perpetual use. The "license agreement" states that the software remains the property of the vendor even though the developer may have no future obligations. Does mere ownership of the software create nexus?
10. Do you have any rules regarding the internet and nexus? For example, if an out-of-state vendor has its software distributed via a web-hosting company who has servers in your state. is nexus created when the software is distributed to a customer in your state?

If you have any Regulations, Statutes, Procedures formal Opinion Letters, and the like dealing with sales tax nexus, I would appreciate receiving a copy of them.

I look forward to hearing from you.

Determinations regarding nexus are very fact specific and cannot be addressed in the context of a General Information Letter. However, we can provide you with basic guidelines that may be used to determine whether a seller would be considered "an Illinois retailer" subject to Retailers' Occupation Tax liability or "a retailer maintaining a place of business in Illinois" subject to Use Tax collection duties from their Illinois customers.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910. The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other

physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Zehnder*, 171 Ill.2d 410, (1996). The retailer's use of a server located in Illinois, in and of itself, is generally not sufficient to establish nexus for sales of tangible personal property made through the Internet.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State.

In Illinois, the transfer of canned computer software is subject to Retailers' Occupation Tax and Use Tax, regardless of the form in which it is transferred or transmitted. See 86 Ill. Adm. Code 130.1935. Canned software that is transferred or transmitted electronically is specifically subject to Retailers' Occupation Tax and Use Tax. See subsection (a) of Section 130.1935. If the computer software consists of custom computer programs, then the sales of such software are not taxable retail sales. See subsection (c) of Section 130.1935.

A license of software is not a taxable retail sale if:

- A) it is evidenced by a written agreement signed by the licensor and the customer;
- B) it restricts the customer's duplication and use of the software;
- C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) the licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) the customer must destroy or return all copies of the software to the vendor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Gina Roccaforte
Associate Counsel

GR:msk
Enc.